3. Merchandise Trade Issues

The introduction of the euro in the final phase of monetary union will occur during the period 1999-2002, and during this period, companies in Member States that are chosen to proceed with EMU will be under no obligation to use the new currency, but will be encouraged to adopt the currency. If the Commission's changeover scenario (Commission of the European Communities (1995)) is to be believed, then there will be little point in using national currency for intra-EU trade as all national currencies will be "irrevocably" fixed from 1999 onwards. Hence, although the euro will not circulate as currency, it will operate as money, in the sense that it will fulfil the four standard characteristics of money[3]. There are clearly both internal effects of adopting the euro, and external effects. To properly understand the external effects, it is necessary to appreciate the internal effects, and it is to these that we turn first.

3.1 Internal (EU) Effects of Adopting the Euro

There are several important consequences of the "irrevocable" fixing of exchange rates for EU participating and non-participating Member States, as well as for nations outside the EU. We first turn to the internal (EU) effects of the adoption of the euro. These include elimination of foreign exchange costs, associated real resource costs of converting currencies, the one-time real resource costs of switching to a new currency, the costs of converting contracts denominated in old currencies, and miscellaneous one-time costs or "vending machine" costs.

The elimination of foreign exchange costs should, in theory, be easily estimated by the bid-ask spreads in the foreign exchange market. This spread represents the competitive rentals of the physical and human resources currently employed in the exchange of currencies which will become redundant once monetary union takes place. As the foreign exchange market might best be described as an imperfectly competitive market, the spread will not represent the social opportunity costs of exchanging currencies as there will likely be some excess profits made by foreign exchange market participants. Of course, most companies also tie up some human and physical resources in exchange of currencies, so the associated real resource costs of converting currencies to companies that trade will exceed the bid-ask spread in the foreign exchange market. Although the Commission (Commission of the European Communities (1990)) estimated these real resource costs, there is little doubt that the estimates were very rough.

The one-time costs of adopting the euro were reviewed by Dowd and Greenaway (1993), and include the in-house costs of creating parallel accounting systems for dealing with euros, the "menu costs" of converting current price lists into the new currency, the legal costs of converting existing contracts into the new currency (if the contract goes to or beyond 2002) and the learning costs (time, training and administration) of dealing with a new currency. Also, there will be a variety of miscellaneous costs associated with the one-time conversion, which do not fall under any particular category ("vending machine" costs).

Once the euro has been adopted there are potentially further costs that may be incurred by EU businesses and governments. One such cost is associated with differing Value Added Tax (VAT) rates in Member States (- VAT rates are not currently harmonised between Member States, and tax bases vary), as there may be increased trade between Member States where the costs of paying the extra

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[3] The four characteristics of money are medium of exchange, store of value, unit of account and standard of deferred payment.